RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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A STUDY OF THE PRICE MOVEMENT: There are a thousand studies of the stock market, and there are hundreds (in many cases, thousands) of loyal followers for each study. Through the years the various stock market techniques and studies gain and lose in popularity, and consequently they tend to come and go. But there is only one study that has withstood the TEST OF TIME. That study is the Dow Theory. When the going gets tough and the stock market picture becomes obscure, I always turn to the Dow Theory.

With this in mind, I feel it is important that we review the recent price action of the D-J Averages as interpreted under Dow Theory. The following section should provide subscribers with an excellent example of the way the Dow Theory works. I have lettered significant points on the page 1 chart, and for the purposes of clarity I will refer to these points.

For new readers, and for many of my friends in this business, I want to repeat that a trend (in the current instance, the BULL trend) is taken to REMAIN IN FORCE until proved otherwise. Then how would the Averages in today's market signal a reversal to a primary bear trend? According to Dow Theory, a bear market is signaled as follows: the two D-J Averages (Industrials and Transports) undergo a full secondary reaction. The Averages then rally. If both Averages can advance to new highs, the bull market will be reconfirmed. But if one or both Averages fail to make new highs, and they turn down -- and BOTH Averages then violate the previous lows, a bear market will be signaled.

With the above paragraph in mind, let's follow the recent price action. At point A (late March) the two Averages, Industrials and Transports, recorded their last joint highs (note: there has not been a single day in which BOTH Averages closed higher). Next a decline carried to April 7, followed by a rise to April 19. Here at point B Industrials recorded a new high of 1855.03 -- but Transports failed to confirm (the weak Transport action was the first hint of trouble in the price structure).

A decline then took Tranports to a new low of 771.10 on May 19 (point C), but here Industrials refused to confirm. Triggered by this non-confirmation, a rally then carried Industrials to another record high (point D) of 1882.35. Again Transports refused to confirm on the upside. A minor decline ensued, followed by yet another record Industrial high (point E) on July 2 of 1909.03. But note at point E that the Transports flattened out (here they appeared terribly weak) and again refused to confirm.

Up to this point we had witnessed no decline in the Averages that I could call of sufficient proportions to be labeled a secondary correction. But following point E the Averages broke badly with Transports sinking to a new low of 709.13 (F) on August 4. At the same time Industrials dropped to a low of 1763.64 (note that at point F the Industrial Average was 5 points above its April 19 low of 1758.18). Nevertheless, at point F I felt that BOTH Averages had dropped far enough so that the decline could be labeled A FULL SECONDARY REACTION.

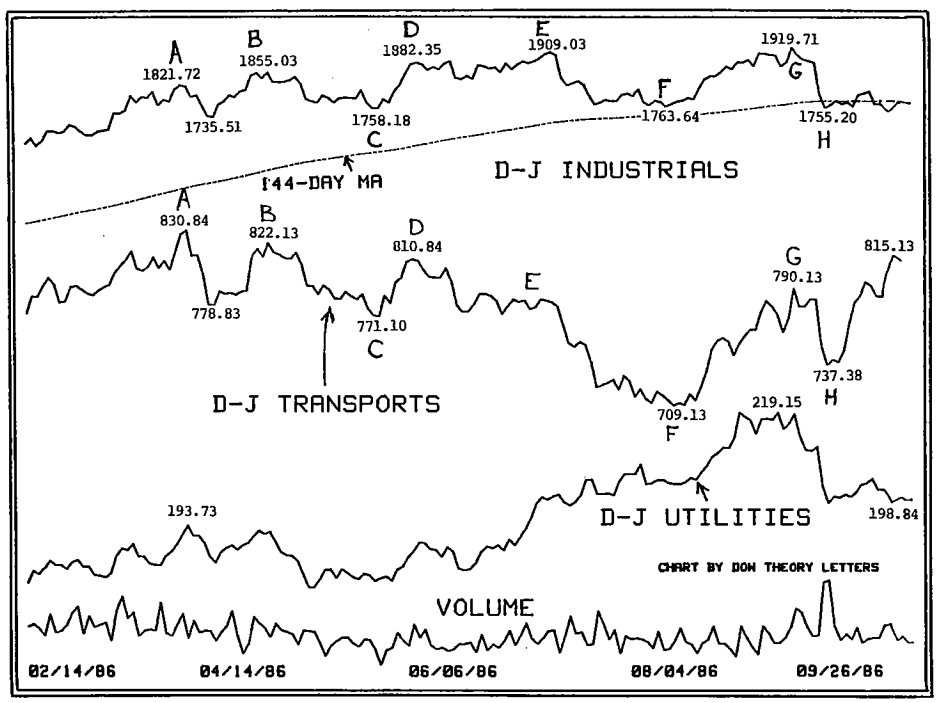
The non-confirmation by Industrials (at F) triggered a new advance which by September 4 took Industrials to yet another record high of 1919.71. As might be expected, the still-weak Transportation Average halted its rise at 790.13, thereby failing again to confirm the new record Industrial high.

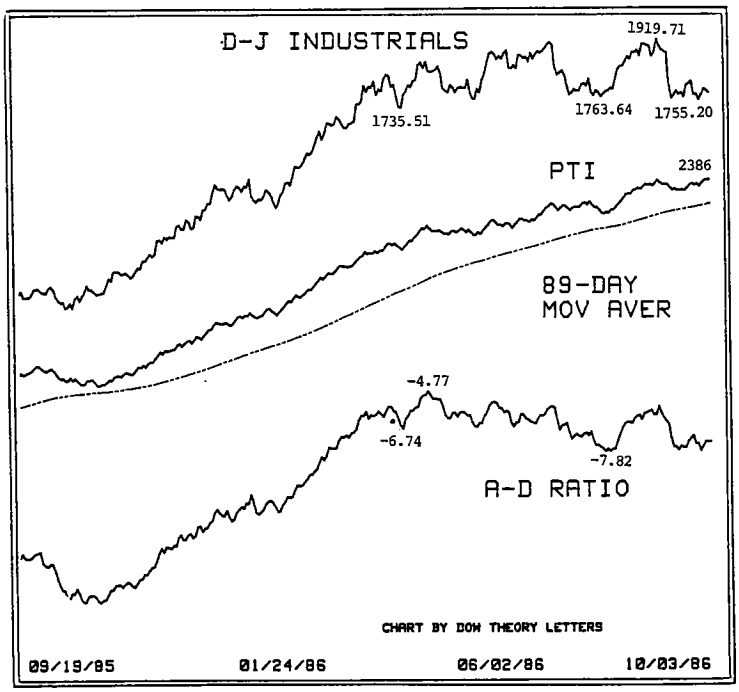
The price action at that point presented us with an IMPORTANT PICTURE UNDER DOW THEORY. Here, for the first time, we had a full secondary correction down to point F, and then a rally back to point G (at which time Transports refused to confirm). This then was the price pattern which would tell us (in due time) whether a bear market had started or whether the bull market was still in force.

If following the highs at point G, the two Averages turned down and violated their lows recorded at point F, a primary bear market would be signaled. Remember, under Dow Theory not one but BOTH Averages must penetrate critical levels before we can draw valid conclusions. A study of history shows that a penetration of a single Average through an important point is meaningless for predictive purposes -- and more often than not is deceptive.

So what happened next? Following the unconfirmed Industrial high, the Averages turned down. And then something dramatic occurred. The Average which had been weaker all along -- turned strong. And, of course, I am referring to the Transportation Average. On September 29 (point H) Industrials dropped to 1755.20, their lowest closing since April. But surprisingly the Transportation Average REFUSED by a wide margin to confirm! At point H the Transports halted their decline a full 28 points ABOVE their August 4 level of 709.13.

This surprising turn–about (i.e., the non-confirmation by Transports at point H) set off a rally, and by October 1 the Transports closed at 815.13, their highest level since June. If a





Dow Theory bear signal was in the cards, the Transportation Average didn't know about it.

CONCLUSION: The tremendous strength of the D-J Transportation Average (and its stubborn refusal to confirm the weakness in the Dow) precludes any possibility of a Dow Theory bear signal at this time. The primary trend of the market remains bullish (see page 6 Late Notes for final update).

INVESTMENT POSITION: The bull stays in the box. Despite much hand-wringing and even some talk of an impending bear market crash, the Dow Theory has given NO bear signal. Furthermore, as you can see on the page 2 chart, my PTI is within points of its bull market high. Finally, the A-D ratio since last March has given up (in the course of six months) only a measly three points. So far, a good performance in a correcting market.

MUSING AHEAD: Last week I walked down to Wind 'n' Sea Beach in La Jolla to do some thinking. Wind 'n' Sea is about a quarter of a mile from my house, it's a public beach, and it's (in my opinion) one of the prettiest beaches in the nation. It is also known for harboring some of the world's comeliest girls (pardon me, women). But despite the distractions of nature, I find Wind 'n' Sea a great place to relax and do some thinking.

The following were some of my thoughts. I thought about the accompanying cartoons, cartoons which I got a laugh out of. But these are also cartoons which I think reflect current public sentiment. The American people are just plain WORRIED. They see what is happening around the nation. They see factories closing, they see their neighbors being laid off, they see farms being auctioned off, and they see a Congress that refuses to deal with the deficit situation. But with it all the Americans continue to love Ronald Reagan. They love him because (1) he is so human and fatherly and sincere, and (2) because nothing seems to truly worry Ronald Reagan. Sure, Ronnie gets mad at Congress and he gets furious at the Russians, but in the end, no matter how horrendous the emergency (and there have been some pretty horrendous ones) Ronnie scolds and scowls -- and comes back smiling and full of encouragement.

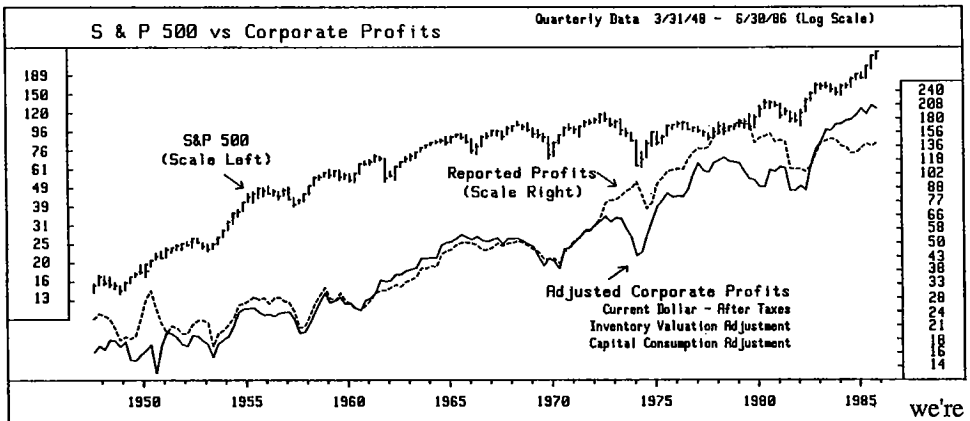
HEY, WE'VE GOT THESE HUGE DEFICITS, AND THE ECONOMY'S GOING SOUR, AND THE ARMS RACE IS OUT OF CONTROL, AND WE'VE TURNED OUR BACKS ON THE POOR, BUT GOSH I FEEL GOOD ABOUT AMERICA.
WHAT'S IN THIS?
I THINK WE SHOULD CANCEL THE REST OF THE EIGHTIES AND GO DIRECTLY INTO THE NINETIES!
Ed Stein
Rocky Mountain News
Newspaper Enterprise Association
BY MAL

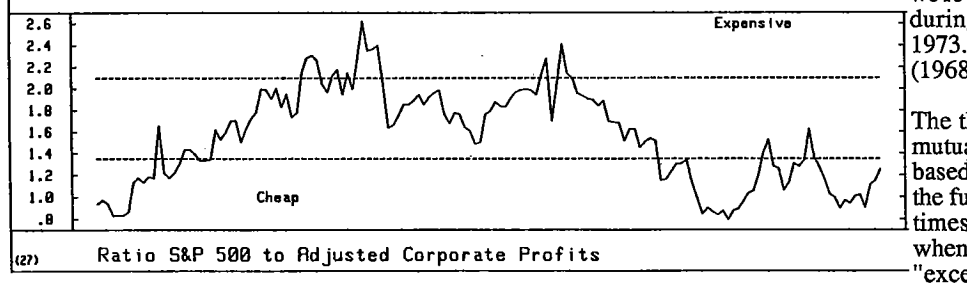
All right, what else? For one thing, I note that an awful lot of market experts, letter writers and analysts are now calling for big trouble on Wall Street. Almost every report I read is warning that a major market top has been formed. "How do they know this?" I ask myself. And the answer is that market breadth has been poor, new highs have been sub-standard, the secondary stocks have been lagging. Furthermore, yields on the Dow and all the major averages are low, price/earnings multiples are high, and the market has gone four years without the widely-expected major correction.

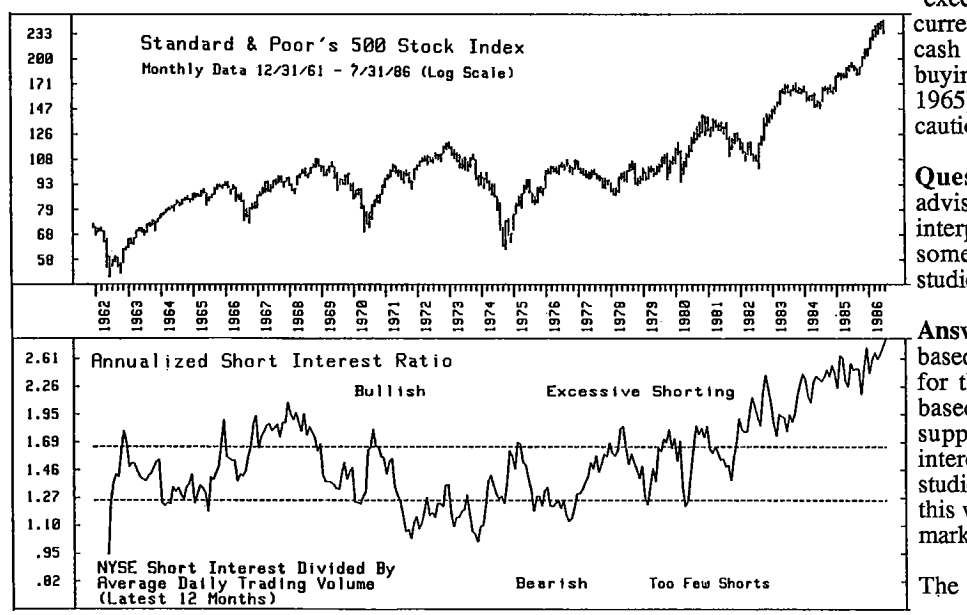
If that's true, I tell myself, if a major top has indeed formed, then the market will confirm it for us by the D-J Averages violating their critical low points. Of course, the Industrial Average has already done this, but the Transports have steadfastly refused to give their half of a bear signal. And if this situation continues (i.e., a Transport non-confirmation) then the well-advertised "top that has been formed" will prove to have been a figment of the experts' imagination. But as usual, Richard Russell operates, not on the verdict of the experts, but on the verdict of THE MARKET ITSELF.

Next question: suppose, just suppose, that all the bears are wrong, and the market holds up and the Transportation Average refuses to break its bear point. Then what? If that happens, it will be obvious that the primary trend is still bullish, and that all the bears have been looking in the wrong direction or following the wrong data.

Anyway, I have a few intuitions , and I'm going to list them here and now. I don't think the bull market is over. I do think we could get a high level consolidation in the D-J Averages, with first one Average and then the other refusing to confirm (on both the upside and the downside) And, of course, this would be the perfect time for the market to do what it does so well -- frustrate the greatest number of participants. If there's one thing that Wall Street fears and loathes, it's an extended trading range (since an extended trading range is usually accompanied by frustration on the part of







but I don't think the arbitrage transactions are rising month after month. No, I believe a lot of the shorting is genuine bearish shorting, shorting by people who think this market is ready to crumble. So far, they've been wrong. And since 1982 they've been horribly wrong. I would guess that they are going to continue to be wrong.

History tells us that near a major top the dominant sentiment is bullishness and elation. Furthermore, history shows us that at or near major tops the short interest tends to decline dramatically while at the same time volume tends to expand. Both of these phenomena work to produce a LOW short interest ratio -- just the opposite of what we're seeing today. (For instance, examine this chart during the major topping areas of late-1968 or 1973. In both instances the ratio was either plunging (1968) or in a low area (1973).)

The third chart shows the Dow along with adjusted mutual fund cash. The adjustment for interest rates is based on the logical thesis that when rates are high, the funds tend to hold more cash (since cash at those times is very profitable). Just the opposite is true when rates are low. Note that the ratio is now in the "excessive cash" area, meaning that the funds are currently cautious, and they are therefore piling up cash (and, of couse, this gives the funds a lot of buying power). Note also that we have never (since 1965) had a big down market when the funds were cautious and the ratio was in the excessive cash area.

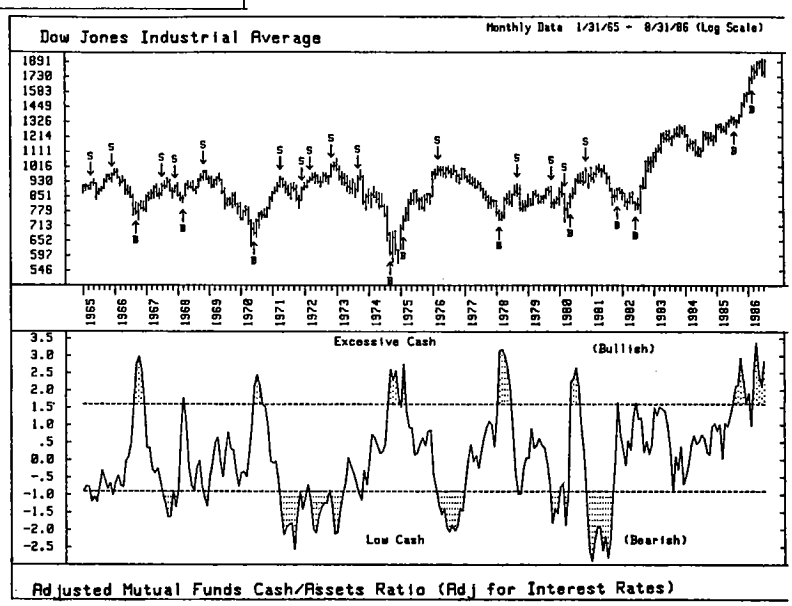
Question: Russell, I note that a good many advisory services are now bearish, based on their interpretation of waves or cycles or Kondratieff or some such thesis. What do you think of these studies?

Answer: It is well to note that all such studies are based on a PRECONCEIVED or pre-charted course for the market. In other words, these studies are based on what the advisors believe the market is supposed to do. I find many of these studies interesting, but as subscribers know, I base my own studies on actual MARKET ACTION. Let me put it this way -- if the information doesn't come from the market itself, then I'm sceptical.

The only information we get from the market is the traders and the public -- and that frustration invariably gives way to low volume).

A number of items do not check with what I "normally" associate with the beginning of a bear market. I'm going to use a few of the fine Ned Davis charts to illustrate my points. The first chart shows the S&P 500 from 1948 to the present along with adjusted corporate profits. The lower section of the chart shows the ratio of the S&P 500 to adjusted profits. Note that the stock market tends to top out when the S&P 500 sells at around 2.2 times adjusted profits. But right now the ratio is a low 1.26. So on this basis the S&P is not overpriced, and it is actually in Davis's "cheap" zone. The market has never topped out in a major way when the S&P 500 was selling at less than 2.0 times adjusted profits.

Next chart: the S&P 500 going back to 1962 with the lower section of the chart showing the NYSE short interest divided by average volume over the preceding 12 months (this is called the annualized short interest). This ratio hit a 12-year low in 1974, and it has been rising bullishly ever since. Right now the ratio is just under 3.00 -- at its highest level in history. I know that arbitrage has somewhat distorted the short interest figures,



action and movement. Therefore, I draw my conclusions from that action and movement. My basic tools for interpreting the market action are the D-J Industrial and Transportation Averages, the A-D ratio, my own PTI, the bonds and various other action-of-the market indicators. When the chips are down and the going gets rough, my textbook for interpreting what the market is doing is the Dow Theory.

Question: If this market holds together in basically bullish fashion, what is your reasoning or rationale for such action?

Answer: I believe I've touched on this before. I think that this nation is now facing an extended period of readjustment, disinflation, debt liquidation and -- well, let's call it "reality-facing." We're seeing quite a bit of this new reality-facing now. Corporations are cutting down on employees and expenses, inefficient corporate divisions are being closed down, sold off or spun off, labor in many cases is being given the choice of lower wages or plant shut-downs, corporate liquidity is being built-up, non-competitive businesses are going under.

The fact is that the US is now facing: (1) vicious and continuing foreign competition, competition that prevents the old "raising the price when the costs start to squeeze"; (2) no inflation or even deflation, and this means that only honest profits will be generated rather than inflation profits based on an increase in inventory values, and (3) a late-in-coming realization that too much debt can kill, particularly in a deflationary environment. Owe a million dollars during an inflationary period and you're a genius. Owe a million during a deflationary period and you're in bankruptcy.

RESPONSIBILITY: I've spent many hours and days pondering "what's wrong with society today" (and I'm talking about US and world society). I was around during the depressing 1930s and the war-torn '40s and the boring '50s and the liberating '60s and the swinging and inflation-ridden '70s and the drug-drenched and debt-ridden '80s so I figure I'm in as good a position as anyone to make some comparisons and comments.

To my mind, the trouble 50 years ago and the trouble today can be traced to one and the same source -- the reluctance of the individual to take responsibility for his or her own actions. Responsibility broken down to its essence means response -- ability: the ability and desire of the individual to respond (and I mean to respond sanely and intelligently to the situation at hand).

What causes people to avoid responsibility? The answers are as follows: (1) ignorance or unawareness -- not knowing how to respond, (2) evil intentions or a diabolical refusal to respond, (3) feelings of inadequacy or the feeling that "I can't or don't have the strength to respond," (4) and this is probably the major cause of irresponsibility -- the perception that "it will be painful or troublesome if I respond."

As I see it, all evil is linked together as if by a common bond. For instance, I see heavy borrowing and big deficit spending as basically evil. Big borrowing is the act of consuming what you do not have and have not earned. You are grabbing pleasure or power today at the expense of someone else's pain (probably your children's) tomorrow. In other words, ultimately, someone has to take the pain (through either inflation or bankruptcy) for the irresponsibility of deficit spending. So deficit spending to me is EVIL, since my definition of evil is PASSING ON THE PAIN OF ONE'S ACT TO SOMEONE ELSE, RATHER THAN ACCEPTING THE PAIN YOURSELF.

And again, that leads me to the concept of responsibility. People tend to shirk responsibility when it entails FEELING PAIN. Let me give you some common examples: You see a child being beaten, but you do nothing because the child's pain isn't your business, and besides, you might get into a lawsuit or a fight if you interfere. Example: Your government is about to pass another stupid law, but you don't write your congressman or senator becauses it's just too much trouble. Example: Your spouse says something totally stupid and insulting to your friend, but you don't call him (or her) on it because it will surely cause a painful argument between the two of you later. Example: Your son comes home half stoned and you fail to confront him on it because "all his friends do it anyway," and it will only alienate him from you. Example: You are smoking and drinking heavily, and you tell yourself that you can handle it or that you are going to "get into a program" in a month or so. And all the while you know that you're feeding yourself the big lie. Final example: a war is on, and you're in the combat zone. A ragged teen-ager appears, and your buddy asks, "He smells like the enemy, shall I blow him away?" You have that violent twinge, that moment of hesitation, but you say, "Yeah, why not?" That yeah costs a boy his life, and you'll never forget your answer as long as you live. But you said it.

So it all boils down to each individual and his conscience and his guts and his willingness to accept the pain of his own action. In my own experience, I have concluded that the willingness to accept responsibility is what separates the good man from the whimp or from the evil man. I believe that responsibility stems from an individual's inner vow to do the right thing and to accept the pain (if pain is involved) in doing the right thing -- no matter what the consequences.

Right now I believe that the very worst example of irresponsibility is being shown by our President and our Congressmen and Senators in allowing the federal deficits to persist. I've felt this way for years, and I've written about it for years. I believe the federal deficits are rotting away the guts of this nation. The refusal by our leaders to take responsibility for the deficits will go down (along with the irresponsibility of the Vietnam War) as the biggest and most tragic mistake in the history of the United States.

Further, I believe that the deficits led to the inflation of the '70s, and that the inflation in turn led the way to a breakdown in the moral fiber of this nation. The moral breakdown has given way to the drug society, the violent society and the illegitimate-baby society. You doubt what I'm saying? Then digest this statistic: 60% of all the welfare in NYC now goes to unwed teen-age mothers. And I guess that's all I have to say at this time about irresponsibility.

DATES & CYCLES: I've never been sold on cycle analysis, but Peter Eliades (Stockmarket Cycles, 2260 Cahuenga Blvd, LA, Calif. 90068) turns out a most studious report -- one that I always read with great interest. In his September 25 report, Peter notes that two of the most important lows in recent stock market history occurred on October 24, 1962 and October 4, 1974. There are 4,363 calendar days between those two dates. Adding 4,363 days to October 4, 1974 we get September 14, 1986. Peter thinks that this extension of the cycle may explain the weakness around that date. And it could also coincide with a major low area around mid-September 1986. Interestingly, Peter then retraces the 4,363-day cycle back from the 1962 low, and he comes up with a date of November 13, 1950. On that day the Dow hit a low of 220.59 (it has never been lower since).

A different approach: "Smart Money" (6 Dear Trail, Old Tappan, NJ 07675) presents another of Yale Hirsch's fascinating studies. Yale notes that bearish Septembers tend to be followed by good last quarters or good following years. He also notes that Octobers tend to be "bear killers." Yale notes that "... remarkable is the fact that fifteen of the seventeen down, flat or slightly up Septembers

BEARISH SEPTEMBERS "REVERSE BAROMETERS"

Year	Sept Change	4th Q Change	Next Year's Change
1982	0.8%	15.9%	17.3%
1979	0.0	— 3.1	25.8
1977	— 0.2	— 3.3	1.1
1984	— 0.4	0.0	26.3
1972	— 0.5	8.5	— 17.4
1978	— 0.7	— 5.0	12.3
1966	— 0.7	7.5	20.1
1971	— 0.7	3.2	15.6
1963	— 1.1	4.5	13.0
1961	— 2.0	6.5	— 11.8
1969	— 2.5	1.0	0.1
1985	— 3.5	13.9	??
1975	— 3.5	11.6	19.1
1962	— 4.8	14.8	18.9
1981	— 5.4	2.5	14.8
1960	— 6.0	9.4	23.1
1974	—11.9	11.5	31.5
Averages	—2.5%	5.8%	13.1%

were followed by years in which the S&P 500 rose." In proof he offers these tabulations (see page 4).

Finally, Yale notes that 1987 is a pre-election year, and there has not been a down pre-election year in the last 47 years (the last one was 1939, just as WW II was getting started).

NOTES & QUOTES: How is our government going to attack the problem of the deficits in 1987? So far, the 1986 attack on the deficit has been through a collection of gimmicks, subterfuges, accounting tricks and sales of public properties. For 1987 one government solution is -- collect more taxes and institute more audits. The IRS will add 2,500 additional examiners per year for the next three years. Thus, those sweating out an audit this year will have a chance to increase their stress and tension next year and in the years thereafter.

* *

How good a president was Ronald Reagan? Obviously, history must be the judge, but in my mind he never addressed what I felt (and I wrote this at the time) was and is the overriding problem of this generation -- the US debt. As such, I judge Reagan a failure. True, Reagan brought back to Americans a feeling of pride in their nation, and true, Reagan triggered the big military build-up, and yes, Reagan showed us the power of the presidency through his strength of character and amazing popularity. But I say that Reagan is a failure because he not only blurred or passed over the deficit problem -- he pushed through the outrageous tax cut of 1981, a cut that sent the federal deficits sky-rocketing and ultimately (since 1980) doubled the total federal debt. Over the past few years, the federal government has been spending $3 for every $2 it takes in. In 1985 it collected 63 cents for every dollar it passed out.

* *

Sports economics: If 49'er quarterback Joe Montana is forced to retire because of back injuries, he will be eligible for $4.25 million in career-ending insurance. State Mutual, a major sports insurer, is no longer quoting policy premiums for football players. Lloyds of London rates have soared 450% for football players since February. The biggest policy ever written covers Marino's $9-million pact with the Dolphins. The premium for this policy is thought to be around $100,000 per year. ... The New England Patriots are for sale by the Sullivan family of Boston. The Super Bowl team is thought to have lost $4 million last year.

* *

With the dollar down around 40% against the yen, the Japanese are buying up US real estate at what must appear to them to be bargain prices. Nowhere is this phenomenon more evident than in Hawaii where it is estimated that the Japanese have spent $1 to $2 billion on assorted real estate over the last year! As a result, prices have been climbing wildly in Hawaii. Last week a Japanese company paid $245 million for a Hyatt hotel near famed Waikiki Beach, a hotel that had sold for $108 million only two years ago. Prices for prime beach hotels have jumped 25% to 50% over the last year. One broker estimates that Japanese now have interests in 75% of the 20 major beachfront hotels at Waikiki Beach. To the victor (in the production wars) go the spoils (US assets).

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Russell's Confessions: When I was in prep school I only played hookie from high school on about half a dozen occasions. Three were trips (I'm blushing) to the Gaiety Burlesque on 42nd Street. The other three were to see Frank Sinatra with Tommy Dorsey's band at the Paramount Theater. For 75 cents (at the 10AM show) I could see a new movie, and then, wonder of wonders, on came the big Paramount stage show. The bandstand would slowly and mysteriously rise from below. The Dorsey band would be playing "I'm Getting Sentimental Over You," a thousand kids would be screaming, and in a few minutes Frank would come on stage -- a skinny little guy with big ears. But when he started to sing -- gangbusters, the crowd would come apart (this was the birth of the bobby soxers phenomenon).

I must be part voyeur, part sentimentalist. I can't put the new book about Sinatra down. The book is Kitty Kelly's "His Way" (Bantam). I find the book fascinating, I really do. And I'll bet you will too (the book has already gone 675,000 hardcover copies, so obviously I'm not the only one who likes it). Kelly interviewed over 800 people in writing this book.

* *

The statistics on murder in the US are staggering. Based on current probability tables, one out of every 164 white males will be murdered sometime in his lifetime. But the most incredible figure is that one out of every 47 black males will be murdered. Thus, in the future 2.12% of all black American males are fated to be murdered! It's beyond belief (statistics from the FBI).

* *

Why the recent interest in oil stocks? According to US Dept. of Energy figures, US companies are finding only 10 million barrels of oil a day while we're consuming 17 million a day. Furthermore, US gas and oil consumption is now rising again. The same is true of natural gas -- we're burning up gas faster than we can discover it. Stated one oil man, "This isn't a glut of gas in reserve, it's a glut of deliverability." In other words, producers drilled extra wells in existing fields in the hopes of building inventories in what was then a super-strong market.

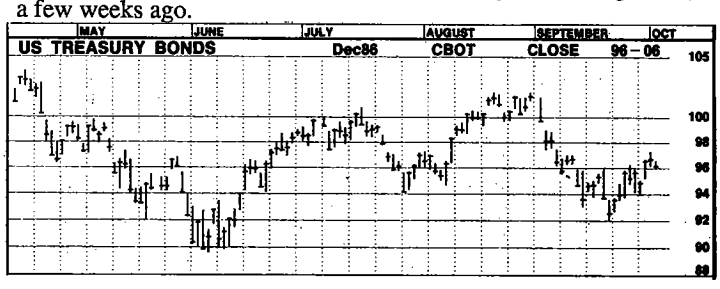
Many industry observers believe that it's only a matter of time before another shortage develops -- probably before the end of the century. And a few investors feel that now is the time to buy cheap oil reserves -- at a time when many of the former oil beauties are hanging on the ropes. Among recommended well-positioned oils: Helmrich & Payne, Murphy Oil, Noble Affiliates, Plains Petroleum, all on the NYSE, all with STRONG balance sheets. Finally, Petroleum Resources Preferred (NYSE), which is convertible into PEO common (the common is a closed-end energy fund which I have often recommended).

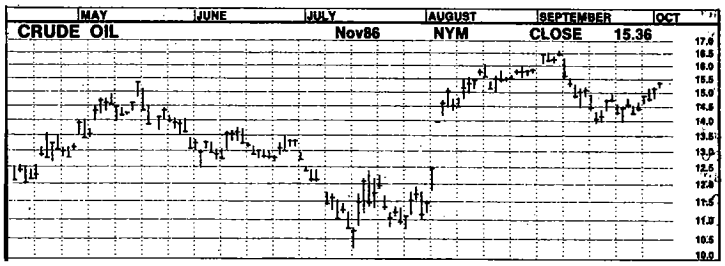
* *

I've seen the real story of the Daniloff affair appear in only one place -- in my ex-father-in-law's newspaper column (Max Lerner). Writes Lerner, "The Western liberal media elite, which has constantly undervalued the importance of the US high-tech revolution, has also refused to recognize that high technology is today for Gorbachev what electricity was once for Lenin -- the necesssary savior of the revolution ... all of which adds up to a single conclusion. The key figure in the whole episode is not Daniloff, newspaperman. It is General Zakharov, high technology spy. Zakharov, be it recalled, was a UN "scientific affairs officer" formally assigned to its Center for Science and Technology for Development. Thus Zakharov was an important noncommissioned officer in the Soviet espionage army -- one of the minions of Gorbachev's science stealers. ... The widespread network had become, for the West, a tolerated nuisance, protected by diplomatic immunity. To the Soviet Union it had become a sacred entitlement, even for spies without diplomatic immunity like Zakharov."

So Daniloff was framed in a first step toward a trade for Zakharov. The Russian's dependence on their science spies dictates that they PROTECT one of their top spies, Zakharov, at all costs. They were, in effect, telling all Russian science spies that their work is of prime importance to Russia and that they will be protected at all costs -- even to the point of fomenting a major international incident.

SIGNIFICANT CHARTS: As I've been saying all along, I believe the bonds (and therefore longer-term interest rates) are now in a well-defined trading range. The accompanying chart (courtesy of Investor's Daily) shows the December T-bond contract with a low range of 90 and a high range of roughly 103. A week ago the bonds bounced off the 92 level (I think they were heavily over-sold there), and my guess is that the Dec. contract could now test the 100 area again. Personally, I have been sitting with my entire bond position, and I added some California munis (general obligations) a few weeks ago.

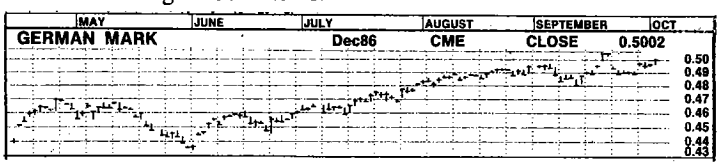




Crude oil: One thing seems clear -- crude oil (following the great crash) bottomed out at near 10 last July. The surest single action in ANY market is the automatic rebound following a true crash. Oil proved no exception. The oil rebound came during late-July to September, carrying the Nov. crude contract to 16.50. From there the crude dropped to 14 in late-September. Last week the Nov. contract pushed over 15. I feel the new bottom for crude is now 14, based on the November contract. And if the crude pushes to 17, I would bet that we would be looking at 20 dollar oil before long.

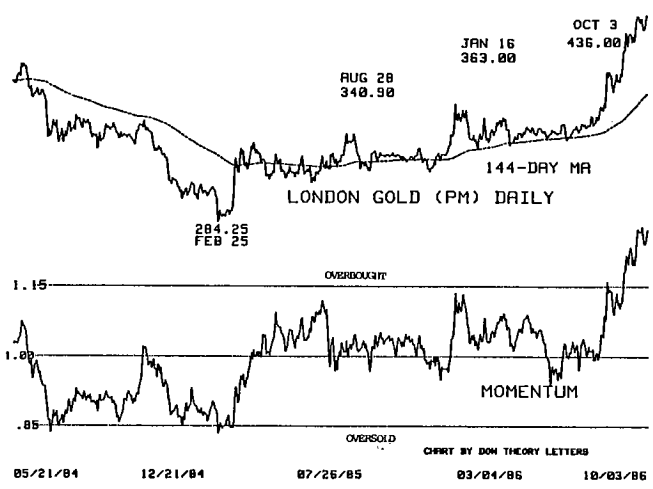
The oil stocks seem to be sensing something like that, and the better integrated oils (Exxon, Royal Dutch) are now extremely resistant to decline. In the market, what won't go down -- goes up.

Everyone is watching to see whether the dollar weakness halts at two German marks for a buck -- or whether the mark gets even more expensive versus the dollar. Here's the chart of the December mark. The answer to the above question should come soon. The most bullish thing about the dollar is that everyone is bearish on it and on the US economy. I wouldn't be surprised that "everyone" could be wrong on both items.



PRECIOUS METALS: Yeah, you bet I get queasy. Here we are in the good old USA, enjoying one of the world's highest standards of living. And we're doing it by utilizing the savings of the rest of the world. While the US is running shocking trade deficits of around $150 billion and up per year, our "prosperity" is being financed by the grace of other nations who, month after month, are buying our ever-expanding paper debt. How long can this fantastic situation last? I'll be darned if I know, but I know one thing -- fantasies don't last forever.

If you're Japanese or German or Swiss, everything in the US looks cheap in terms of your own strong currency, and that means cheap US stocks, bonds, real estate, corporations, and it also means cheap gold (which has hardly moved up in terms of the strong foreign currencies). So you're buying, and US "items" are being scooped up by the carload.



My chart of gold is telling a clear and simple story. Gold is acting bullishly -- almost too bullishly. The metal has shot up far above its rising144-day moving average, which now stands at 371. At the same time, the gold momentum index has exploded way above the overbought area of 1.15. In a super-bullish atmosphere any item can stay over-bought. Nevertheless, it should not surprise anyone if gold now corrects at least halfway back to its moving average. Such a correction could take gold back to 400. Remember, it doesn't have to happen that way, but that kind of action would be completely normal.

On a relative strength basis, gold is definitely out-performing common stocks. Gold is now up 53% from its 284 low of February 1985 and 34% up from where I issued my first buy signal. Keep buying those gold coins. Personally, I've doubled my monthly purchases of coins (last week I bought Krugerrands at prices BELOW actual gold content; the Krugies are a bargain today)

The gold stocks: most of the non–South African mines have too many shares outstanding and most of the same gold stocks have minuscule yields. Now I don't deny that there may be a lot of growth potential in these North American and Australian mines, but without good yields there isn't much to hold them up in the event of a gold correction. Therefore, I personally prefer just to keep building my collectlion of monetary (non-numismatic) gold coins. Is it too late to buy platinum coins? I don't think so, but I'd rather wait for a correction. Note: The world has only a two year supply of platinum and Russia and S. Africa produce almost all of it.

Gold Thoughts: Nation after nation is now issuing gold coins, even including such Asian countries as Singapore and China. And the US, after denouncing gold since the 1930s, has done a total flip-flop and is about to issue its own "gold eagle." What's going on?

It occurs to me that consciously or unconsciously, the WHOLE WORLD may be turning to a "new currency," one that's 5000 years old. It's called gold. If so, if this is what is happening, how will this affect the world economy? My own feeling is that the turn to gold is all part of a phenomenon that I have been writing about for quite some time. It is part of a major transition period (which will take years) in which debt will unwind, inflation will simmer down, and individuals and corporations will gradually become more conservative.

People may go in debt, but not all people are fools. In their hearts men don't trust debt (although they're happy to use it). In economic history, when men don't like what they see -- they turn to gold. I believe that is what is happening now.

LATE NOTES: Many investment advisors are flat out calling this "a bear market." Maybe so, but those advisors are doing it on the basis of intuition, seat-of-the-pants instinct, a crystal ball or some system of their own. It may indeed be a bear market, but Dow's Theory has not said so, and Dow's Theory is the system I depend on.

Despite weakness in the composite averages and in the D-J Industrial Average, the Transports continue to frustrate the bears. The D-J Transportation Average contains stocks in the airline, trucking and railroad group. Many (actually most) of these issues are heavily leveraged, and this makes them particularly sensitive to trends in shipping and the economy. In other words, an impending economic downturn invariably hits the leveraged issues harder, and for this reason I am particularly interested in the strength of the carriers.

On October 3 my PTI (page 2 chart) closed at 2386, a new record high for the bull market. Obviously, the new PTI high has not been confirmed by any of the major stock averages, but a succession of new PTI highs has not in my experience been associated with a bear market (and I now have 15 years of experience with the PTI).

NEXT MAILING: Oct. 22